

Message Text

PAGE 01 STATE 309057

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C O N F I D E N T I A L STATE 309057

E.O. 11652: GDS

TAGS: ENRG, ECON, OPEC, XF

SUBJECT: OPEC'S SPLIT DECISION AT DOHA

CONFIDENTIAL

PAGE 02 STATE 309057

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THE FOLLOWING IS AN INR SPECIAL ASSESSMENT:

1. SUMMARY. THE TWO-TIER OIL PRICE SYSTEM WHICH EMERGED FROM THE DOHA OPEC MEETING APPEARS TO CREATE AN UNSTABLE SITUATION. WHILE IT EVIDENCES THE INTERNATIONAL STRAINS ON THE CARTEL, PARTICULARLY THOSE BETWEEN SAUDI ARABIA AND SUCH PRICE HAWKS AS IRAN AND IRAQ, WE DO NOT BELIEVE IT MEANS THAT OPEC IS LIKELY TO BREAK UP, NOR NECESSARILY THAT THE SAUDIS CAN OR WILL ALWAYS WANT TO DICTATE

MODERATE INCREASES. WITH ECONOMIC ACTIVITY IN THE WEST STILL SOFT AND WITH LARGE STOCKS ON HAND, IT SEEMS LIKELY THAT THE MAJORITY OF OPEC WILL NOT BE ABLE TO IMPOSE AN IMMEDIATE TEN PERCENT PRICE INCREASE, ESPECIALLY IF SAUDI ARABIA INCREASES PRODUCTION TO CAPACITY. IF THE TWO-TIER PRICE STRUCTURE WERE TO BE MAINTAINED, IT WOULD RAISE THE FREE WORLD'S OIL BILL IN 1977 BY ABOUT 13 BILLION DOLLARS ABOVE THAT WITH FROZEN PRICES. A FLAT FIVE PERCENT INCREASE WOULD ADD 6.3 BILLION DOLLARS ONTO THE FREE WORLD'S OIL BILL. THE TWO-TIER PRICE STRUCTURE WOULD ALSO COST THE OIL-IMPORTING LDCS 1.3 BILLION DOLLARS, OR 500 MILLION DOLLARS ABOVE THE 800 MILLION DOLLARS ADDITIONALLY PLEDGED BY OPEC AT DOHA. LATER IN THE YEAR, SAUDI ARABIA

MIGHT GO ALONG WITH A HIGHER OIL PRICE, ESPECIALLY IF DEMAND FOR OIL TURNS FIRM AND A LOWER PRICE FOR SAUDI OIL WOULD MERELY MEAN HIGHER PROFITS FOR THE OIL COMPANIES.

2. OPEC'S SPLIT DECISION AT DOHA. IT WAS GENERALLY EXPECTED THAT THE DECEMBER 15-17 OPEC OIL MINISTERS' CONFERENCE IN DOHA, QATAR WOULD CAUSE SPIRITED DEBATE, BUT THAT THE DIFFERENCES WOULD BE NEGOTIATED AND COMPROMISED. TO EVERYONE'S SURPRISE A COMPROMISE BETWEEN THE SAUDIS ON THE ONE HAND AND THE LARGE FACTION LED BY IRAN ON THE OTHER HAND WAS NOT ACHIEVED. THE RESULT IS A TWO-TIER PRICE FOR OPEC OIL. THE MAJORITY DECISION, ACCEPTED BY ONLY 11 OF THE 13 OPEC STATES, WAS TO INCREASE PRICES BY CONFIDENTIAL

PAGE 03 STATE 309057

15 PERCENT IN TWO STAGES--TEN PERCENT EFFECTIVE JANUARY 1ST AND ANOTHER FIVE PERCENT ON JULY 1ST. SAUDI ARABIA AND THE UNITED ARAB EMIRATES DECIDED TO INCREASE THEIR PRICES BY ONLY FIVE PERCENT.

3. THE ANNOUNCED PRICES, REPRESENTED AS IS OPEC'S USUAL PRACTICE IN TERMS OF 'MARKER CRUDE,' ARE 12.70 DOLLARS PER BARREL AS OF JANUARY 1ST AND 13.30 DOLLARS PER BARREL AS OF JULY 1ST FOR THE ELEVEN, AND 12.08 DOLLARS PER BARREL AS OF JANUARY 1ST FOR SAUDI ARABIA AND THE UAE. THERE IS A STRONG PARADOX IN THE ELEVEN'S USE OF THIS PRACTICE AT DOHA, SINCE THE MARKER CRUDE IS SAUDI LIGHT, AND THE MAJORITY COULD NOT IN FACT CONTROL THE SAUDI PRICE THIS TIME.

4. THE SPLIT-PRICE DECISION ALLOWED A STATEMENT TO BE ISSUED AND PREVENTED THE MEETING FROM ENDING IN EVEN GREATER DISARRAY--IMPORTANT IN PRESERVING OPEC UNITY--BUT IT PAPERS OVER A WIDE GULF. SAUDI ARABIA ORIGINALLY INSISTED ON A SIX-MONTH PRICE FREEZE WHILE IRAN, IRAQ, AND MOST OF THE OTHER COUNTRIES INSISTED THE INCREASE SHOULD BE AT LEAST 15 PERCENT.

5. SAUDI ARABIA MODIFIED ITS POSITION ONLY AFTER OIL MINISTER YAMANI FLEW BACK FOR CONSULTATION WITH CROWN PRINCE FAHD, WHO WAS ACTING AS REGENT, AND BY PHONE WITH KING KHALID WHO WAS IN SWITZERLAND. AFTER YAMANI'S RETURN, THE SAUDI DELEGATION SIMPLY STATED FIVE PERCENT AS ITS FINAL POSITION AND MADE LITTLE FURTHER ATTEMPT TO PERSUADE ANY OTHER DELEGATIONS TO SWITCH OVER. THE UAE HAD ALREADY PROMISED TO FOLLOW THE SAUDIS LEAD ON WHATEVER INCREASE THEY FINALLY PROPOSED.

6. IRAN, AND MOST OF THE OTHER TEN COUNTRIES WHICH FINALLY STUCK WITH THEM WERE NOT PREPARED TO SETTLE FOR

CONFIDENTIAL

PAGE 04 STATE 309057

LESS THAN TEN PERCENT FOR 1977 AS A WHOLE, AND THERE WAS CONSIDERABLE BITTERNESS ABOUT BOTH THE SAUDIS' POSITION AND YAMANI'S TACTICS.

7. IN A PRESS CONFERENCE AT THE END OF THE MEETING, YAMANI SAID:

--SAUDI ARABIA WOULD LIFT ALL RESTRAINTS ON OIL PRODUCTION AND LET THE MARKET DECIDE HOW MUCH IT WOULD PRODUCE.

--HE EXPECTS THE WEST, ESPECIALLY THE UNITED STATES, TO SHOW ITS "APPRECIATION" FOR SAUDI ARABIA'S OIL PRICING RESTRAINT BY HELPING BRING ABOUT A MIDDLE EAST PRICEDDDE PEACE SETTLEMENT AT GENEVA AND BY CONCEDING SOMETHING TO LDC DEMANDS IN THE NORTH-SOUTH DIALOGUE.

--THE SAUDI ACTION DOES NOT MEAN THE BREAKUP OF OPEC.

--THE FIVE PERCENT INCREASE WILL ONLY TAKE FROM THE OIL COMPANIES THE EXTRA PROFIT THEY HAVE BEEN MAKING RECENTLY IN THE OPEN MARKET BECAUSE SPOT PRICES HAVE BEEN ABOVE THE OPEC "MARKER CRUDE" PRICE. (SPOT MARKET CRUDE PRICES ARE NOTORIOUSLY VOLATILE AND AND UNREPRESENTATIVE OF THE PRICES AT WHICH NEARLY ALL CRUDE MOVES UNDER CONTRACT. SINCE SPOT PRICES HAVE RISEN IN LARGE PART IN ANTICIPATION OF OPEC'S PRICE INCREASE, THEY WOULD PROBABLY HAVE DROPPED IN THE ABSENCE OF SUCH AN INCREASE. HAD NO INCREASE AT ALL BEEN VOTED, IT IS UNLIKELY THAT THE OIL COMPANIES WOULD HAVE BEEN ABLE TO REAP THE EXTRA PROFIT YAMANI CLAIMS.)

8. OTHER OPEC COUNTRIES HAVE ALSO EMPHASIZED THAT CARTEL SOLIDARITY IS NOT THREATENED, BUT ALL EXPRESS THE HOPE THAT SAUDI ARABIA WILL NOT HURT THEM BY SIGNIFICANTLY INCREASING PRODUCTION TO CUT INTO THEIR MARKET SHARES. MANY ALSO WARN AGAINST "GAMES" BY THE OIL COMPANIES TO
CONFIDENTIAL

PAGE 05 STATE 309057

BUY AT THE LOWER PRICE AND SELL AT THE HIGHER ONE.

9. WHILE CONSUMER COUNTRIES MAY BE TEMPTED TO TAKE COMFORT FROM THE DISPLAY AT DOHA OF THE TRADITIONAL DIFFICULTIES WHICH FACE CARTELS, IT WOULD CERTAINLY BE A MISTAKE TO ASSUME THAT OPEC IS LIKELY TO BREAK UP OR THAT THE SAUDIS CAN OR WILL ALWAYS SHARPLY RESTRAIN PRICE INCREASES. ALL OF THE MEMBERS RECOGNIZE THE BENEFITS THEY OBTAIN FROM THE CARTEL AND NONE HAVE ANY INTEREST IN SEEING IT BREAK UP. HOWEVER BITTER THEY MAY BE, THEY WILL STRIVE TO PAPER OVER THEIR DIFFERENCES AND PRESENT AS SOLID A FRONT TO THE WORLD AS BEFORE.

10. THE SITUATION WHICH EMERGED FROM DOHA, HOWEVER, SEEMS CLEARLY UNSTABLE, AND IT APPEARS HIGHLY UNLIKELY THAT THE DUAL OIL PRICE SYSTEM CAN BE SUSTAINED FOR LONG. SAUDI ARABIA SEEMS SERIOUS IN ITS INTENT TO INCREASE PRODUCTION AS CALLED FOR TO BRING THE OPEC PRICE DOWN TO ITS FIVE PERCENT INCREASE. IT PROBABLY WILL NOT BE ABLE TO BRING ENOUGH PRODUCTION ON STREAM FAST ENOUGH TO LIMIT THE OVERALL PRICE INCREASE TO FIVE PERCENT, BUT WITH ECONOMIC ACTIVITY IN THE WEST SOFT AND LARGE STOCKS ON HAND, IT SHOULD BE ABLE TO COMPEL SUBSTANTIAL SHAVING FROM THE TEN PERCENT INCREASE ADOPTED BY THE REMAINING OPEC COUNTRIES, IF IT FOLLOWS THROUGH ON ITS STATED INTENTION TO DO SO.

11. SAUDI ARABIA IS ESTIMATED TO HAVE EXCESS PRODUCING CAPACITY OF TWO TO THREE MILLION BARRELS PER DAY AT PRESENT, AND CAN EASILY PUSH UP PRODUCTION BY AT LEAST ONE MILLION B/D IN A MATTER OF DAYS AND BY MORE IN A MATTER OF MONTHS. THUS FAILURE TO MEET SAUDI PRICES COULD MEAN A SUBSTANTIAL LOSS IN MARKET SHARES FOR THE ELEVEN, AND ONCE ANY PRICE REDUCTION TAKES PLACE IN ONE OR MORE COUNTRIES, OTHER COUNTRIES WOULD FIND HOLDING OUT PROGRESSIVELY MORE DIFFICULT.

CONFIDENTIAL

PAGE 06 STATE 309057

12. THERE ARE CERTAIN CONTRACTURAL AGREEMENTS WHICH THE COMPANIES HAVE WITH VARIOUS MEMBERS OF THE ELEVEN, AND THESE MEMBERS CAN BE EXPECTED TO APPLY AS MUCH PRESSURE ON THE COMPANIES AS POSSIBLE TO KEEP UP THEIR LIFTINGS ON PAIN OF LOSS OF FUTURE ACCESS. ON THE OTHER HAND, MANY OF THESE COUNTRIES HAVE BEEN THE REGULAR "DISCOUNTERS, IN THE PAST AND THERE ARE INDICATIONS SOME PARTICULARLY INDONESIA, PROBABLY WILL NOT EVEN TRY TO IMPLEMENT THE FULL TEN PERCENT TO BEGIN WITH.

13. IT IS, THEREFORE, PROBABLE THAT THE ELEVEN WILL HAVE

TO MODERATE THEIR ANNOUNCED HIGHER INCREASES, ALTHOUGH THEY WILL USE VARIOUS DEVICES, SUCH AS MANIPULATION OF DIFFERENTIALS, EXTENDING LONGER CREDITS, ETC., TO PUT A "FIG LEAF" ON THEIR ACTIONS AND AVOID ANY FORMAL DECLARATION.

14. THE NEXT REGULARLY SCHEDULED MEETING OF OPEC MINISTERS WAS SET AT THE DOHA MEETING FOR JULY 12, 1977, BUT THERE IS NOTHING TO PREVENT THEM FROM CALLING A SPECIAL MEETING AT ANY TIME. THERE WILL CERTAINLY BE PRESSURE FOR AN EARLY MEETING TO WORK OUT THEIR DIFFERENCES AND REACH A COMPROMISE SINGLE PRICE.

15. IF THE TWO-TIER STRUCTURE WERE TO BE MAINTAINED AND THE PERCENTAGES PRODUCED BY THE TWO GROUP OF OPEC COUNTRIES WERE TO REMAIN THE SAME AS THEY HAVE BEEN RECENTLY THE EFFECTIVE INCREASE FOR THE FIRST HALF OF 1977 WOULD BE 8.3 PERCENT, FOR THE LAST HALF 11.6 PERCENT, AND THE AVERAGE FOR 1977 AROUND TEN PERCENT. IF THE PERCENTAGES RECEIVED FROM EACH GROUP OF OPEC COUNTRIES BY EACH OF THE CONSUMING COUNTRIES WERE TO REMAIN THE SAME AS THEY HAVE BEEN RECENTLY (AS SHOWN BELOW) AND IF DEMAND GROWS AT CURRENT RATES, THE IMPACT ON THE MAJOR INDUSTRIALIZED COUNTRIES WOULD BE AS FOLLOWS:
CONFIDENTIAL

PAGE 07 STATE 309057

RECENT PERCENT PROJECTED INCREASE
OF OPEC IMPORTS FROM IN OIL BILL
COUNTRY SAUDI ARABIA OTHER (BILLION DOLLARS)
AND UAE OPEC

UNITED STATES	31.7	68.3	3.8
CANADA	28.8	71.2	0.1
JAPAN	52.2	47.8	1.8
UNITED KINGDOM	26.4	73.6	0.5
WEST GERMANY	26.8	73.2	1.5
FRANCE	48.9	51.1	0.9
ITALY	37.0	63.0	0.9
AVG FOR EEC			
"BIG FOUR,	35.4	64.6	--

AVERAGE PERCENT EFFECTIVE
PRICE INCREASE
1ST HALF 2ND HALF 1977
COUNTRY

UNITED STATES	8.4	11.8	10.1
CANADA	8.6	12.1	10.4
JAPAN	7.4	9.8	8.6
UNITED KINGDOM	8.7	12.4	10.6
WEST GERMANY	8.7	12.3	10.5
FRANCE	7.6	10.1	8.8

ITALY 8.2 11.3 9.8
AVG FOR EEC

"BIG FOUR" 8.2 11.5 9.9

FOR THE FREE WORLD AS A WHOLE, THE INCREASE IN OIL IM-
PORT BILLS OVER WHAT THEY WOULD BE WITH THE PRICE OF OIL

FROZEN IS ESTIMATED AT 12.7 BILLION DOLLARS IF THE TWO-
CONFIDENTIAL

PAGE 08 STATE 309057

TIER PRICE IS MAINTAINED, AS AGAINST 6.3 BILLION DOLLARS
FOR AN ACROSS-THE-BOARD FIVE PERCENT INCREASE.

16. THE OIL MINISTERS ALSO DECIDED UNANIMOUSLY AT DOHA
TO INCREASE OPEC'S ASSISTANCE TO OIL-IMPORTING DEVELOPING
COUNTRIES BY 800 MILLION DOLLARS, CITING THEIR DESIRE
"TO ENHANCE SOLIDARITY WITH OTHER LDCS AND THEIR EFFORTS
TO ATTAIN A NEW INTERNATIONAL ECONOMIC ORDER." THE
800 MILLION DOLLARS ONLY REPRESENTS AROUND SIX PERCENT OF
THE ADDITIONAL REVENUES OPEC NATIONS CAN EXPECT FROM
THE PRICE INCREASE. FURTHERMORE, IF THE OIL-IMPORTING
LDCS WERE TO FIND THEMSELVES PAYING THE WORLD AVERAGE FOR
THEIR OIL IMPORTS AND IF THEIR DEMAND GROWS AT RECENT
RATES, THEIR OIL BILL WILL INCREASE BY ABOUT 1.3 BILLION
DOLLARS, 0.5 BILLION DOLLARS OR 62.5 PERCENT MORE THAN
THE ADDITIONAL AID VOTED THEM BY OPEC.

17. WHILE IT IS DIFFICULT TO SAY EXACTLY WHAT THE
SITUATION WILL BE IN SIX MONTHS FROM NOW, THE SAUDIS
MAY DECIDE OR FEEL FORCED TO GO ALONG WITH A LARGER
INCREASE BY THAT TIME. IF THE WESTERN ECONOMIES REBOUND
STRONGLY AND THE DEMAND FOR OIL BECOMES VERY STRONG,
THEY MAY DECIDE THAT THE MARKET CALLS FOR AN INCREASE
AND THAT IF THEY DON'T TAKE THE PROFIT THE OIL COMPANIES
WILL. FURTHER MODERATION ON THEIR PART MAY BE FORTH-
COMING FOR POLITICAL REASONS, HOWEVER, IF THEY FEEL
GOOD PROGRESS IS BEING MADE TOWARD A MIDDLE EAST PEACE
SETTLEMENT.
ROBINSON

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MILAN

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